

Chapter 12 Summary of End-of-Chapter Problem Revisions

2014 Edition Problem Number	2013 Edition Problem Number	2014 Edition Modifications
1	1	
2	2	
3	3	Solution updated
4	4	
5	5	
6	6	
7	7	
8	8	
9	9	Problem updated
10	10	
11	11	
12	12	
13	13	Solution updated
14	14	
15	15	
16	16	Solution modified
17	17	Problem modified
18	18	Problem modified
19	19	Problem modified
20	20	modified
21	21	Problem modified
22	22	Problem modified
23	23	Solution updated
24	24	Solution updated
25	25	
26	26	Problem modified
27	27	
28	28	
29	29	
30	30	
31	31	
32	32	Problem updated
33	33	
34	34	
35	35	
36	36	
37	37	
38	38	Problem modified
39	39	Problem updated
40	40	Problem updated
41	41	Problem modified

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42	42	Problem updated
43	43	Problem updated
44	44	Problem modified
45	45	Solution modified
-	46	Problem deleted
46		New Problem
47	47	Solution modified
48	48	
49	49	
50	50	
51	51	Problem updated
52	52	
53	53	
54	54	
55	55	Problem updated
56	56	
57	57	Solution modified
58	58	Problem updated
59	59	
60	60	
61	61	Solution updated
62	62	Problem updated
63	63	Problem updated
64	64	Solution updated
65	65	

Solutions to Chapter 12 Problem Assignments

Check Your Understanding

1. *Gift Determination*

Solution: No, it is simply an arms-length sale.

2. *Gift Determination*

Solution: Sharon must relinquish her right to change beneficiaries for this to be a completed gift.

3. *Gift Tax Exclusion*

Solution: The annual gift tax exclusion of \$14,000 (\$13,000 prior to 2013) was enacted for taxpayer and administrative convenience to eliminate small gifts (birthday, wedding, etc.) from gift taxes.

4. *Present vs. Future Interest*

Solution: A present interest is an interest that is received at the time the gift is made and it allows the recipient to benefit from and enjoy the gift property immediately. A future interest does not take place until sometime in the future and the enjoyment of property is postponed until then.

5. *Gift to Minor*

Solution: The requirements for gifts made into a Section 2503(c) minor's trust are: (1) The trustee may pay the income and/or trust assets to the beneficiary before the beneficiary reaches age 21. (2) The income and the assets must be distributed to the beneficiary when he or she reaches age 21. If the beneficiary dies before age 21, the trust property must be distributed to the beneficiary's heirs or estate. A Crummey trust could also qualify for the annual exclusion. A Crummey trust does not require a distribution of assets when the beneficiary reaches age 21; however, it must have an annual demand provision.

6. *Life Insurance Proceeds*

Solution: If the decedent's estate is the beneficiary or the decedent retained any incidents of ownership (for example, the right to change beneficiaries or to borrow against the policy) in the policy, the proceeds will be included in the decedent's estate.

7. *Life Insurance Transfers*

Solution: a. Yes. Troy has made a gift at the time of the transfer but the value of the gift is only equal to the cost of an equivalent policy.

b. No. The proceeds are not included in his estate because he retained no incidents of ownership at the time of his death and the gift was not made within 3 years of his death.

8. *Estate Valuation*

Solution: Estate property (except IRD) is valued at fair market value at the date of the decedent's death or, if elected, the alternate valuation date. The alternate valuation date is 6 months after the decedent's death and can be used only if the executor makes an irrevocable election on the estate tax return and both the gross estate and estate tax are reduced by using the alternate date. If the alternate valuation date is elected, but the property is sold prior to that date, the sale value of the property is included in the estate.

9. *Unified Credit*

Solution: The lifetime unified credit amount for 2013 is \$2,045,800 [$\$345,800 + (.40 \times \$4,250,000)$]; this is equal to a related exclusion equivalent of \$5,250,000. The unified credit is the amount available to a donor and/or the donor's estate to offset all or a portion of the donor's gift tax and/or the donor's (now deceased) estate tax liability. The unified credit was \$1,772,800 for 2012 and the exclusion equivalent was \$5,120,000.

10. *Generation Skipping Transfers*

Solution: Making gifts of property to third- and fourth-generation descendants by-passes gift taxes that would be owed by passing the property to directly succeeding generations. For example, great grandfather gifts \$10,000,000 to his great grandson, by-passing both the grandfather and the father. A gift tax is paid once only. If the gift is passed to the grandfather, a gift tax will be paid then; when the remaining amount is gifted to the father, another gift tax is paid. The remainder that is left to be gifted to the great grandson will be much less than \$10,000,000 now due to these intervening gift taxes. The generation-skipping transfer tax is designed to penalize these "skips." If it did not exist, making these gift skips would preserve more wealth within a family.

11. *Estate Planning*

Solution: Sidney has transferred both income (the \$35,000 annual rent) and a potentially appreciating asset (the building) to his daughter. This transfer shields the post-gift appreciation from estate tax and provides the family annual income tax savings from income shifting (assuming the daughter is in a lower marginal tax bracket than Sidney).

12. *Income in Respect of a Decedent*

Solution: IRD is income earned by a cash-basis taxpayer but not yet received at death. IRD receives no basis step-up and is taxed as income to the beneficiaries (or the estate, if not distributed).

13. *Estate Taxation*

Solution: The income tax rate for income earned by assets held within an estate is extremely high, reaching 39.6 percent at \$11,950 in 2013 (35 percent at \$11,650 in 2012). Distributing the estate assets quickly transfers the income earned on the assets to beneficiaries who may be in lower marginal tax brackets.

14. *Adjusted Taxable Gifts*

Solution: Adjusted taxable gifts is the term given to the sum of all taxable gifts made by the decedent after 1976. The total amount of a decedent's adjusted taxable gifts is added to his or her taxable estate (gross estate less allowable deductions). The transfer tax rates are then applied to this total. The tentative tax is then reduced by a credit for gift taxes paid on the post-1976 gifts based on the current tax rates and credit amount. Including adjusted taxable gifts in the calculation of the estate tax subjects the taxable estate to higher marginal tax rates.

15. *Trust Characteristics*

Solution: A simple trust must (1) distribute all of its accounting income annually to the beneficiaries and (2) cannot make charitable contributions. Complex trusts do not have to distribute all accounting income and they can make charitable contributions.

16. *Distributable Net Income*

Solution: DNI determines the maximum distribution deduction by the estate or trust and the maximum taxable distribution for the beneficiaries (regardless of the amount actually distributed).

Crunch the Numbers17. *Gift Determination and Valuation*

Solution: a. \$60,000 (\$90,000 fair market value - \$30,000 selling price).
 b. There is no gift until the daughter withdraws money.
 c. There is no gift when the property is transferred because the trust is revocable. If any income is paid to the daughter, then the income would be a gift when paid from the trust.

18. *Gift Determination and Valuation*

Solution: a. Cynthia makes a taxable gift of \$4,000 (\$18,000 - \$14,000 annual exclusion) when the trustee distributes that amount to Eileen.
 b. Services are not subject to gift tax.
 c. \$1,000 gift (\$15,000 - \$14,000 annual exclusion). The medical expenses must be paid directly to the provider to be excluded.
 d. There is no taxable gift because the money is paid directly to the university.

19. *Gift Determination and Valuation*

Solution: a. Stephanie makes a \$15,000 gift in July when Michael withdraws the funds.
 b. There is no gift as the money is paid directly to the hospital.
 c. There is no gift as the money is paid directly to the university.
 d. \$85,000 gift.
 e. Miguel does not make a gift until the trustee makes the \$20,000 distribution to Juan; at that time Miguel makes a \$20,000 gift of the money to Juan.

20. *Gift Valuation*

Solution: $\$570,000 = (\$40 + \$36)/2 = \$38 \times 15,000$ shares.

21. *Gift Splitting*

Solution: a. $\$160,000 = (\$30,000 - \$14,000) \times 10$.

b. $\$10,000 = (\$15,000 - \$14,000) \times 10$. Lisa also has \$10,000 in taxable gifts.

22. *Gift Splitting*

Solution: a. $\$24,000 = (\$20,000 - \$14,000) + (\$32,000 - \$14,000)$. The gift to her husband is not taxable.

b. $\$2,000 = (\$16,000 - \$14,000)$. The gift to the daughter is now less than their combined gift annual exclusions. Ginny's husband also has \$2,000 in taxable gifts.

23. *Gift Splitting*

Solution: a. \$244,000 combined taxable gifts. Marah: $(\$20,000 - \$14,000) + (\$60,000 - \$14,000) + (\$100,000 - \$14,000) = \$138,000$.

Bryan: $\$120,000 - \$14,000 = \$106,000$.

b. \$196,000 combined taxable gifts. Marah and Bryan: $(\$30,000 - \$14,000) + (\$50,000 - \$14,000) + (\$60,000 - \$14,000) = \$98,000$ each. The gift to Sam is less than their two annual exclusions when gift splitting is elected.

24. *Gift Splitting*

Solution: \$46,000 total gift exclusions = \$28,000 (2 x \$14,000) for \$30,000 cash gift + \$18,000 (2 x \$9,000) for gift of marketable securities. The remainder interest is not eligible for the annual exclusion.

25. *Present vs. Future Interest*

Solution: a. This is a future interest, but it is eligible for the annual gift exclusion as a Section 2503(c) minor's trust.

b. Present interest for the \$10,000 transferred each year.

c. Present interest equal to the cost of a comparable policy at that date.

26. *Gift Planning*

Solution: a. \$4,365 tax savings. For 2013, a zero tax rate applies to dividend income and long-term capital gains for individuals in the 10% or 15% marginal tax brackets; for single individuals that would include taxpayers with taxable income of less than \$36,250 for 2013. Eileen has \$2,100 dividend income and a long-term capital gain of \$27,000 ($\$39,000 - \$12,000$ basis) resulting in \$29,100 gross income. Eileen's taxable income is \$19,100 ($\$29,100 - \$6,100 - \$3,900$), all subject to a 0% tax rate in 2013. Note that Eileen cannot be a dependent because she is age 24 and her income exceeds \$3,900.

Parent's tax on transferred income: $\$2,100 \times 15\% = \315 . Capital gains tax: $\$27,000 \times 15\% = \$4,050$. Total tax = $\$4,050 + \$315 = \$4,365$.

- b. No. Assuming the parent's gift split, neither parent will have made a taxable gift as their annual exclusion now reduces taxable gifts to zero $[(\$28,000 \times 50\%) - \$14,000]$.

27. *Gross Estate Determination*

Solution: a. Nothing included; the life estate ends with the beneficiary's death.
b. \$60,000 included.
c. \$50,000 included in gross estate.

28. *Gross Estate Determination*

Solution: a. \$400,000.
b. \$400,000.
c. \$100,000.

29. *Gross Estate Determination*

Solution: \$80,000. This is a gift that had strings and it was transferred within three years of death; thus, it must be brought back into the estate.

30. *Gross Estate Determination*

Solution: a. \$89,000.
b. \$102,000.

31. *Taxable Estate Determination*

Solution: \$1,000,000 - \$16,000 fee - \$15,000 funeral expenses - \$110,000 charitable contribution - \$700,000 marital deduction = \$159,000 taxable estate. A promise to pay without a valid contract is not an enforceable debt.

32. *Basis of transferred Property*

Solution: a. \$80,000; Jessica's basis.
b. Date of death value of \$800,000.
c. If the son plans to keep the land, then the basis will not be very important to him, so Jessica should consider giving the land to him now as the gift tax exclusion equivalent in 2013 is \$5,250,000. If the son eventually decides to sell the land, the appreciation may be taxed to him at the capital gains rate (current maximum 20 percent in 2013). There may be no estate tax due, however, when Jessica dies as the current estate tax exclusion equivalent is \$5,250,000. These provisions were changed at the end of 2012 for 2013 and beyond providing for indexing of the exclusion equivalent. Unless she has other valuable assets that will increase the value of her estate beyond the tax offset by the unified credit at the time of her death, she would not be subject to any estate tax.

33. *Grantor Trust*

Solution: a. Zero. Mark has no income from these transfers; they are income to George because this is a grantor trust. The distribution is a gift to Mark.
b. George has \$30,000 of income because this is a grantor trust.

34. *Trust Income*

Solution: a. \$160,000.
b. Barbara as beneficiary.
c. The trust, per the trust document.

35. *IRD*

Solution: \$72,000 of IRD, assuming none of the distribution from the retirement plan represented income on which taxes had already been paid by the decedent prior to death.

36. *Trust Income*

Solution: \$70,000 is taxed to the children; \$30,000 is taxed to Wayne, the income from the newly contributed assets, as he retained rights to that income.

37. *Trust Income*

Solution: a. \$12,000 from the trust in year 1.
b. \$18,000 from the estate in year 2.

38. *Gift Tax Calculation*

Solution: $\$1,005,800 = \$345,800 + [40\% \times (\$2,650,000 - \$1,000,000)]$.

39. *Gift Tax Calculation*

Solution: \$3,500,000. $\$345,800 + [40\% \times (\$14,000,000 - \$1,000,000)] = \$5,545,800 - \$2,045,800$ unified credit

40. *Estate tax Determination*

Solution: \$1,440,000. Tax on taxable estate of \$8,850,000: $\$345,800 + [(\$8,850,000 - \$1,000,000) \times \%] = \$3,485,800$ gross estate tax - \$2,045,800 unified credit = \$1,440,000 estate tax. Note that unless a decedent has used all or part of the unified credit to offset taxable gifts, a taxable estate of \$5,250,000 or less would not pay any estate tax in 2013.

41. *Gift tax determination*

Solution: a. \$50,320. \$200,000 gift - \$14,000 annual exclusion = \$186,000 taxable gift
Gift tax on \$186,000 = $\$38,800 + [.32 \times (\$186,000 - \$150,000)] = \$50,320$
Cherry must use \$50,320 of her unified credit to offset the gift tax. She pays no tax at this time.
b. \$4,721.25 saved. Nancy has \$13,200 (12 x \$1,100) in Social Security income and \$18,000 (.09 x \$200,000) interest income on the bonds. As her total income (\$31,200) exceeds \$25,000 but does not exceed \$34,000, one-half of the amount that her social security income that exceeds \$25,000 must be included in her taxable income or \$3,100 [$.5(\$31,200 - \$25,000)$] Her taxable income is \$11,100 (\$18,000 + \$3,100 - \$3,900 exemption - \$6,100 standard deduction) and her tax is \$1,218.75 [$\$892.50 + .15 \times (\$11,100 - \$8,925)$]. Cherry's tax on the \$18,000 interest would have been \$5,940 (\$18,000 x .33). Thus they have saved the \$4,721.25.

42. *Gift tax determination***Solution:** No gift taxes owed.

<u>Sondra</u>		<u>Jason</u>
\$ 450,000	½ house to Sondra's mother	\$ 450,000
450,000	½ house to Sondra's father	450,000
475,000	Condo to Jason's mother	475,000
500,000	Local charity	500,000
250,000	Sondra's sister	250,000
250,000	Jason's brother	250,000
375,000	Best man	375,000
<u>125,000</u>	Church	<u>125,000</u>
\$2,875,000	Total gifts	\$2,875,000
-112,000	Less: Annual exclusions (8 x \$14,000 each)	- 112,000
<u>- 597,000</u>	Less: Charitable deductions (\$625,000 – \$28,000)	<u>- 597,000</u>
\$2,166,000	Taxable gifts for current period	\$2,166,000
-0-	Plus: Prior taxable gifts	<u>200,000</u>
\$2,166,000	Total taxable gifts	\$2,366,000

	Gift tax on cumulative gifts – Sondra	
\$ 812,200	$\$345,800 + [(\$2,166,000 - \$1,000,000) \times 40\%]$	
<u>- 812,200</u>	Less: Available unified credit used	
0	Gift taxes payable – Sondra	
	Gift tax on cumulative gifts – Jason	
	$\$345,800 + [(\$2,366,000 - \$1,000,000) \times 40\%]$	\$ 892,200
	Less: Available current period unified credit used	892,200
	Less: Credit for taxes paid on prior taxable gifts at current rates but prior unified credit	<u>- 0</u>
	Gift taxes payable – Jason	0

Tuition paid directly to the university is not a taxable gift.

43. *Estate Tax Determination*

Solution: \$297,600. Taxable estate: \$7,000,000 gross estate - \$26,000 funeral expenses - \$30,000 administrative expenses - \$350,000 charitable deduction - \$600,000 marital deduction = \$5,994,000.

Estate tax = $\$345,800 + [(\$5,994,000 - \$1,000,000) \times 40\%]$ = \$2,343,400 gross estate tax - \$2,045,800 unified credit = \$297,600 estate tax.

44. *Kiddie Tax*

Solution: a. \$595. Lenny's taxable income: \$3,500 - \$1,000 standard deduction = \$2,500; Lenny's tax: $(\$1,000 \times 10\%) + (\$1,500 \times 33\%) = \$100 + \$495 = \$595$.

b. \$250. If Lenny is 24, his tax is: $(\$3,500 - \$1,000) \times 10\% = \$250$, assuming Lenny is a dependent. If Lenny were not a dependent, he would be entitled to claim a standard deduction of \$6,100 and a personal exemption of \$3,900 resulting in no taxable income and no tax liability.

Think Outside the Text

These questions require answers that are beyond the material covered in this chapter.

45. *Estate and Gift Tax Reform*

Solution: One of the most plausible reasons for having kept the gift tax while eliminating the estate tax was that when property was passed during life, the giver may have been transferring the income from that property to lower income taxpayers, reducing future income taxes from that property. Thus, paying a gift tax could potentially make up for this lost revenue. For very wealthy persons, the ability to transfer income producing assets to lower taxed family members could have overridden the gift tax cost, particularly if the gifted property had appreciation potential. For others, however, the gift tax would prevent the transfers if they felt the tax too burdensome. Congress may have also retained the gift tax while repealing the estate tax to encourage people to wait until death to transfer assets possibly to ensure that assets are retained to care for themselves until death. It ended up that both the gift and estate taxes have been continued only with much higher amounts exempted from these taxes. Thus, new planning strategies will be developed to use these changes to taxpayer's advantage.

46. *Estate and Gift Tax Reform*

Solution: The easiest change for Congress to make in the future would be to increase the top rates or to abandon the inflation adjustments as a way of increasing the revenue from this source. The current administration appears to like the use of surtaxes, however, when income levels hit upper limits. A series of surtaxes could also be imposed when certain gift or estate levels are reached while keeping the rate schedules currently in effect. In this way the rates can be raised on the wealthier donors or the larger estates of decedent's estates without any overt increase in the rates applicable to most persons.

47. *Loan or Gift*

Solution: This is a gift-loan—but the principle is not an outright gift unless it is never repaid. There is an agreement for repayment—but there is no interest provision. Interest will be imputed on the loan. The father will have to recognize interest income; the imputed interest paid by the son will be deductible only to the extent of the income from the investment. When the father accepts the \$280,000 in repayment of the loan after five years, the \$20,000 (\$300,000 - \$280,000) that is not repaid is a gift at that time eligible for the annual and lifetime exclusions.

48. *Kiddie Tax*

Solution: The kiddie tax as originally enacted was meant to discourage high income taxpayers from transferring income producing assets to young children who, in most cases, would not understand the issues involved in investing. Originally targeted at children under the age of 14, the age has been raised several times so that now it applies to children under the age of 19 (24 if a full-time student) and that age is quite arbitrary. By age 19, however, most young persons understand some aspects of money management and may begin to have some unearned income from investing money they themselves may have earned. The law most

likely does achieve the goal of discouraging transfers of assets simply because it is so complex. One way to simplify the law would be to tax a child's unearned income above a minimum amount at a higher tax rate without the necessity of relating that rate to the parents' rate. This law also taxes income that a child below the target age may have earned from assets purchased with money that he or she also earned at the parents' rate, discouraging savings by children and other young adults.

49. *Disinheriting a Wife*

Solution: If they live in a community property state, half of the marital assets belong to the wife. If they live in a state that recognizes a wife's dower interest in the estate, a minimum amount (usually one-third or one-half of the estate) automatically passes to the wife regardless of any will. In states with either of these provisions, it is not possible to prevent a spouse from inheriting any assets. To thwart the will provisions in other states, Ellen generally would have to prove that Myron was incompetent at the time the will was drawn or acting under duress to receive a share of the estate.

Identify the Issues

Identify the issues or problems suggested by the following situations. State each issue as a question.

50. *Gift Determination*

Solution: Does the gift of the auto constitute a gift subject to the gift tax or is it in the nature of support for her son?

51. *Estate Income and IRD*

Solution: How much of the \$6,000 dividend and \$3,200 interest is IRD? How will the IRD be taxed on the decedent's final income tax return and how much, if any, income will be included in the gross estate?

52. *Estate Value*

Solution: How much, if anything, of the value of the trust assets will be included in Carolyn's estate?

53. *Estate Deductions*

Solution: How is the \$6,000 credit card bill treated for estate tax purposes? Are alternative treatments available?

54. *Property Settlement of a Decedent*

Solution: What is the proper tax treatment for the \$200,000 payment to Loren prior to Tim's death and the \$400,000 payment by the executor subsequent to his death?

55. *Real Estate of Foreign Resident*

Solution: Are there any estate tax consequences for Jorge's estate for the Miami Beach real estate owned at death as a noncitizen, nonresident of the United States?

56. *Trusts*

Solution: What type of trust is this and who will be taxed on its income?

57. *Trusts*

Solution: How will the transfer affect the taxation of the trust income and distributions to beneficiaries? Are the tax rates to which the income from the corporate bonds is subject so high that the after-tax return for the beneficiaries from these will be less than the non-taxable interest from the investment in tax-exempt securities? Will the tax-exempt bonds be as marketable as the corporate bonds should a sale become necessary in the future?

Develop Research Skills

Solutions to research problems are included in a separate file.

Search the Internet

60. *Estates of Foreign Nationals*

Solution: a. A nonresident alien decedent is a decedent who is neither domiciled in nor a citizen of the United States at the time of death. For purposes of this form, a citizen of a U.S. possession is not a U.S. citizen.

b. The executor must file Form 706-NA if the date of death value of the decedent's gross estate located in the United States under the Internal Revenue Code rules defining property "located within the U.S." exceeds the filing limit. The filing limit is \$60,000 reduced by the sum of (1) the gift tax specific exemption (Section 2521) allowed with respect to gifts made between 9/9/1976 and 12/31/1976, inclusive, and (2) the total taxable gifts made after December 1976 that are not included in the gross estate. (If the executor made the special election to use the carryover basis for decedents dying in 2010 for tangible property situated in the United States, no 706-NA is required to be filed.)

61. *Gift Splitting*

Solution: Generally, a husband and wife may not file a joint gift tax return to elect split gifts. Each spouse is responsible for filing his or her own gift tax return. If they elect gift splitting, they must file separate gift tax returns (unless one of the following exceptions is met) but each must sign the other's gift tax return signifying consent to the gift splitting.

Exception 1: During the calendar year, only one spouse made any gifts, the total value of these gifts to each third-party donee does not exceed \$28,000, and all of the gifts were of present interests.

Exception 2: During the calendar year, only one spouse (the donor spouse) made gifts of more than \$14,000 but not more than \$28,000 to any third-party donee, the only gifts made by the other spouse (the consenting spouse) were gifts of not more than \$14,000 to third-party donees other than those to whom the donor spouse made gifts, and all of the gifts by both spouses were of present interests.

If either of the above exceptions is met, only the donor spouse must file a return and the consenting spouse signifies consent on that return.

If they live in a community property state and the gift is of community property or if the gift is of property held jointly or as tenants by the entirety, they are required to each file a gift tax return.

Develop Planning Skills

62. Estate Valuation

Solution: \$7,600,000. Using the alternate valuation date gives a total estate value of \$7,600,000 (\$2,200,000 + \$4,620,000 + \$780,000). The \$2,200,000 date of sale valuation must be used for the stock rather than the \$2,180,000 on the alternate valuation date. Because this total is \$20,000 is less than the date of death valuation, estate taxes are reduced by \$8,000 (40% x \$20,000). This also reduces the gain on which the estate (or the beneficiary) will have to pay taxes due to the bond sale by up to \$4,000 (\$20,000 x 20%). Thus, using the alternate valuation date provides significant tax savings.

63. Estate Tax and Planned Gift Giving

Solution: a. \$1,420,000 tax due. Gross estate = (\$3,800,000 x 50%) + \$4,700,000 + \$1,400,000 + \$900,000 + \$800,000 + \$1,000,000 = \$10,700,000
 Taxable estate: \$10,700,000 - \$1,900,000 marital deduction = \$8,800,000
 Gross tax = \$ 345,800 + [40% (\$8,800,000 - \$1,000,000)] = \$345,800 + \$3,120,000 = \$3,465,800
 Tax due = \$3,465,800 - \$2,045,800 unified credit = \$1,420,000
 b. \$1,056,000. {(12 grandchildren + 4 children) x [(4 years x \$13,000) + (1 year x \$14,000)]}.

64. Gift Selection

Solution: a. The cash can be invested in income producing assets but only \$1,900 of income will be taxed to the daughter (less if she has any other unearned income) due to the imposition of the kiddie tax prior to her turning 19 years of age (24 if a full-time student). The basis of the cash is \$13,000 when received.

The corporate stock has increased in value but the daughter will get the lower \$6,000 basis for determining gain. The dividend income is minimal and should be tax-free due to her zero dividend tax rate as long as her other unearned income does not exceed \$2,000.

The S corporation is making a significant amount of income; transferring ownership of 10 percent will transfer a maximum of \$1,900 of income to the daughter (less if she has other unearned income) to be taxed at her lower marginal tax rate due to imposition of the kiddie tax prior to her turning 19 years of age (24 if a full-time student). As this is a family corporation, care must be taken to ensure that reasonable salaries are paid to family members who work in the business before the net income is determined.

The limited partnership interest losses would be of little or no use to the daughter as they are passive losses and she must have passive income to offset it. If Ted has not been able to deduct the passive losses from the partnership in prior years, the question arises whether the transfer of this interest to his daughter would qualify as

a disposal and allow him to deduct losses that have been suspended from prior years.

b. In the short term, it would appear that the best asset to transfer would be either the \$13,000 cash or the corporate stock. It is highly unlikely that investing the \$13,000 cash or the dividends on the stock will result in any significant tax (if any) to the daughter as the income would have to exceed \$1,000 to be taxed in 2013 (unless she had other unearned income). The daughter would then have cash available for use later (for example, for college expenses) or she could sell the corporate stock at capital gains rates which could be as low as 0% based on 2013 tax rates if she has little or no other income. The transfer of the S corporation stock would only allow up to \$2,000 of income to be taxed at the daughter's tax rate; however the remaining income (\$6,000) would be taxed at the father's highest marginal tax rate until she turns 19 (24 if a full-time student). The father could achieve some additional tax savings by employing his daughter in the S corporation if at all possible. If he waits until she turns 19 (24 if a full-time student) to gift this stock, he can avoid the imposition of the kiddie tax. If the father takes minimal distributions from the S corporation during this time, the stock basis will increase as income increases. Long-term planning, however, may suggest gifting the S corporation stock, even if only \$2,000 is taxed at the daughter's tax rate for several years. She would be building basis in her stock as she and her father are taxed on the income—with the father presumably paying the taxes. Later, she could take distributions from the S corporation without incurring any additional tax expense. As a family business, involving the daughter at this stage may also encourage her to continue the business and the current tax cost may be a small price to pay.

65. *Trust Assets*

Solution: a. If an election is made to recognize the gain on the sale of the land, the \$15,000 of capital gain would be allocated to corpus and would offset the \$14,000 of net capital losses, leaving only a \$1,000 gain taxed to the trust. The beneficiary will get a basis in the land of \$55,000 rather than \$40,000.

b. If the election is not made, the trust recognizes no income on the distribution and the beneficiary gets a \$40,000 basis in the land. When the beneficiary sells the land, he or she will have to recognize gain or loss based on the \$40,000 basis. The capital loss in the trust cannot offset any of the resulting gain. The trust could only deduct \$3,000 of capital loss in the current year against other income and the remaining portion would have to be carried forward.

c. It would be to the trust and beneficiary's advantage to elect to recognize the gain. This allows the losses to be deducted currently at a cost of a tax on only \$1,000 of gain. This also provides a much higher basis to the beneficiary for the planned sale of the land.